

COMMONWEALTH OF VIRGINIA
STATE CORPORATION COMMISSION
AT RICHMOND, OCTOBER 15, 2008

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APPLICATION OF

APPALACHIAN POWER COMPANY

CASE NO. PUE-2008-00045

For adjustment to capped electric rates pursuant
to § 56-582 B (vi) of the Code of Virginia

FINAL ORDER

On May 30, 2008, Appalachian Power Company ("Appalachian" or "Company") filed with the State Corporation Commission ("Commission") an application seeking adjustment of the Company's capped electric rates pursuant to § 56-582 B (vi) of the Code of Virginia ("Code"). Specifically, Appalachian seeks to revise its surcharge for the recovery of its incremental environmental compliance and transmission and distribution system reliability costs ("E&R costs"). Appalachian has requested that the Commission permit the proposed surcharges to be effective for electric service rendered on or after January 1, 2009.

The Company stated that Code § 56-582 B (vi) permits recovery of incremental costs for compliance with state and federal environmental laws and regulations ("environmental costs") and for transmission and distribution system reliability ("reliability costs") after July 1, 2004, and that the cost recovery sought in its application represents the Company's incremental environmental and reliability costs incurred between October 1, 2006, and December 31, 2007.

Appalachian asserted that it has incurred incremental costs during the period October 1, 2006, through December 31, 2007, resulting in a total net revenue requirement of \$66.5 million. The Company stated that the calculation of the revenue requirement is consistent with methodologies approved by the Commission in its two previous E&R costs cases. *Appalachian Power Company*, Case No. PUE-2005-00056 and Case No. PUE-2007-00069. The Company

requested an 11.75% rate of return on common equity. The Company proposed to recover this revenue requirement through surcharges applied to the Company's rate schedules for service to customers subject to the jurisdiction of the Commission. The appropriate surcharges would be applied to customers' bills each month for electric usage during the period January 1, 2009, through December 31, 2009. The Company proposed a single, per kWh E&R factor by class and voltage level to be applied to customers' kWh usage to recover E&R expenses. The Company stated that this methodology should be simpler and easier for customers to understand, and it should mitigate the potential for over-recovery of E&R costs.

On June 6, 2008, the Commission issued an Order for Notice and Hearing directing Appalachian to provide notice of its application; inviting comments on the application by interested persons; scheduling a public hearing on the application for September 17, 2008; and establishing a procedural schedule for the filing of testimony and exhibits by respondents and the Commission Staff.

Notices of participation were filed by the Office of the Attorney General's Division of Consumer Counsel ("Consumer Counsel"), Steel Dynamics-Roanoke Bar Division ("Steel Dynamics"), the VML/VACo APCo Steering Committee ("VML/VACo"), and the Old Dominion Committee for Fair Utility Rates ("Old Dominion Committee").

On July 14, 2008, the Old Dominion Committee filed a Motion for Expedited Consideration and Dismissal ("Motion"). The Old Dominion Committee asserted that the Company's application could not proceed as filed given that by statute capped rates expire on December 31, 2008, and therefore, could no longer be adjusted under § 56-582 B (iv) of the Code. Both Appalachian and Consumer Counsel filed a response opposing the Old Dominion

Committee's Motion on July 25, 2008. On August 14, 2008, a Hearing Examiner's Ruling was issued denying the Motion and directing that the matter proceed as scheduled.

Prefiled testimony was submitted by the Old Dominion Committee, Steel Dynamics, and Consumer Counsel on August 13, 2008. The Old Dominion Committee's prefiled testimony opposed the Company's proposal to design its surcharge on a kWh basis. Likewise, Steel Dynamics' prefiled testimony opposed the proposed kWh-based surcharge and recommended that the Company revert to its previous method for recovering E&R costs. Both the Old Dominion Committee and Steel Dynamics took issue with the method of E&R cost allocation. Consumer Counsel's prefiled testimony focused on whether the \$66.5 million of costs sought by Appalachian represent properly justified E&R costs.

On August 30, 2008, the Staff filed testimony recommending that the total revenue requirement be reduced to \$65,844,000, using the Staff's cost of capital and including a \$9.088 million cost¹ that would be moved into this proceeding from the ongoing general rate case in Case No. PUE-2008-00046. The Staff further recommended reducing the revenue requirement to remove the costs of transmission and distribution projects included in the application which were not based on reliability or environmental needs, but rather were needed to serve new load growth.

A public hearing was convened on September 17, 2008, during which Senator William Roscoe Reynolds testified in opposition to the proposed increase. On September 19, 2008, the hearing was reconvened wherein the parties and Staff submitted a jointly executed stipulation ("Stipulation") recommending a resolution of the issues in this proceeding.

¹ \$9.088 million is Appalachian's Virginia jurisdictional share of the non-penalty portion of the settlement of a federal action for alleged violations of the New Source Review ("NSR") of the Clean Air Act.

The Stipulation provides that Appalachian, the Old Dominion Committee, Consumer Counsel, VML/VACo, Steel Dynamics, and the Staff agree that the Commission should adopt a revenue requirement of \$60.6 million for the Company to recover E&R costs through a monthly surcharge for service rendered during calendar year 2009. The Stipulation provides that the stipulated revenue requirement includes \$4.55 million of the approximately \$9.1 million Virginia jurisdictional share of the NSR settlement, with the balance subject to review and challenge in the Company's next E&R proceeding. The \$60.6 million revenue requirement reflects a \$300,000 reduction arising from the removal of costs related to six projects involving line relocation and a \$350,000 reduction in costs allocated to projects challenged as being related to load growth rather than system reliability. The Stipulation is based upon Staff's recommended capital structure, provides a manner to allocate the revenue requirement among the customer classes, and provides for a surcharge design utilizing demand and energy factors to be applied on a kWh basis and a kW basis where appropriate. With regard to cost allocation, the Stipulation requires that the Company file a fully allocated class cost of service study in its next E&R case.

The Report of Howard P. Anderson, Jr., Hearing Examiner, was issued on September 26, 2008. As noted by the Hearing Examiner, the proposed rate increase engendered a large response from the public - 1,046 letters were received, along with 666 witness signatures on petitions, and 78 e-mails from customers, all opposed to the proposed increase. The Hearing Examiner's Report reviewed the procedural history of the case and found the Stipulation to be acceptable. Therefore, the Hearing Examiner recommended that the Commission adopt the Stipulation submitted by the participants in this proceeding.

NOW THE COMMISSION, having considered the Hearing Examiner's Report, the record, pleadings, and applicable law, is of the opinion and finds that the findings and

recommendations in the Hearing Examiner's Report should be adopted and that the jointly executed Stipulation should be accepted as a fair and reasonable resolution of this proceeding.

Accordingly, IT IS ORDERED THAT:

(1) The Company's application seeking adjustment of its capped electric rates pursuant to § 56-582 B (vi) of the Code of Virginia is granted in part, and denied in part, as set forth herein.

(2) The Findings and Recommendations in the Hearing Examiner's September 26, 2008 Report are adopted, and the Stipulation of the parties and Staff is hereby accepted.

(3) The Company shall implement a line-item surcharge, designated on customer bills as "Environmental & Reliability Cost Recovery Surcharge," to recover the \$60.6 million revenue requirement approved herein for incremental E&R costs prudently incurred from October 1, 2006, through December 31, 2007.

(a) Such surcharge shall be effective for service rendered on and after January 1, 2009, and shall be calculated in accordance with the Stipulation of the parties.

(b) Such surcharge shall be designated to recover the \$60.6 million revenue requirement approved herein for service rendered during the 12 months ending December 31, 2009.²

(c) Such surcharge shall cease for service rendered after December 31, 2009.

(d) Any future E&R surcharge shall address any under- or over-recovery of the revenue requirement approved herein.

² The current surcharge approved in Case No. PUE-2007-00069 recovers \$48.9 million. That surcharge ceases as of December 31, 2008. Effective January 1, 2009, the \$60.6 million surcharge will replace that earlier surcharge. Hence, the net increase in annual E&R surcharge to be paid by customers is \$11.7 million.

(4) Consistent with the findings made herein, the Company shall forthwith file with the Commission's Division of Energy Regulation revised tariffs, effective for service rendered on and after January 1, 2009.

(5) The Company shall keep track of all base rate and surcharge recoveries of incremental E&R costs on a continuing basis and shall provide reports of same to Staff as may be reasonably requested.

(6) There being nothing further to come before the Commission, this matter is dismissed from the Commission's active docket and the papers filed herein placed in the Commission's file for ended causes.

AN ATTESTED COPY hereof shall be sent by the Clerk of the Commission to:
Anthony J. Gambardella, Esquire, Woods Rogers P.L.C., 823 East Main Street, Suite 1200, Richmond, Virginia 23219; Shaun C. Mohler, Esquire, and Damon E. Xenopoulos, Esquire, Brickfield, Burchette, Ritts & Stone, P.C., 1025 Thomas Jefferson Street, N.W., Eighth Floor, West Tower, Washington, D.C. 20007-5201; Edward L. Petrini, Esquire, Christian & Barton, L.L.P., 909 East Main Street, Suite 1200, Richmond, Virginia 23219-3095; C. Meade Browder, Jr., Senior Assistant Attorney General, Division of Consumer Counsel, Office of Attorney General, 900 East Main Street, 2nd Floor, Richmond, Virginia 23219; and the Commissions Office of General Counsel and Divisions of Energy Regulation, Public Utility Accounting, and Economics and Finance.

A True Copy
Teste:


Clerk of the
State Corporation Commission